INFORMATION BULLETIN

2009-9

December 22, 2009

Harmonization with Various Measures Relating to Federal Tax Legislation and Regulations and Deferral of Taxation of an Eligible Rebate

This information bulletin provides a detailed description of the application details relating to various harmonization measures with federal tax legislation and regulations. It also details the changes made to the measure relating to the deferral of taxation of an eligible rebate.

For information concerning the matters dealt with in this information bulletin, contact the Secteur du droit fiscal et de la fiscalité at 418 691-2236.

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Finances Québec

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1. HARMONIZATION WITH FEDERAL TAX LEGISLATION AND REGULATIONS

1.1 Act to implement certain provisions of the budget tabled in Parliament on January 27, 2009 and related fiscal measures

On March 12, 2009, the Parliament of Canada passed an Act to implement certain provisions of the budget tabled in Parliament on January 27, 2009 and related fiscal measures.[1]

This legislation includes changes to Part IV of the Income Tax Regulations concerning the determination of taxable income earned in a province by a corporation. These changes are further to the agreement entered into by the federal government and the Ontario government under the Memorandum of Agreement concerning a single administration of Ontario corporate tax.[2]

Following examination of these regulatory changes, it is appropriate to announce the integration of some of these measures in Québec's tax regulations with application on the same dates as for the purposes of the federal tax regulations.

More specifically, Québec's tax regulations will be amended to incorporate, with adaptations on the basis of their general principles, the following measures:

— recognition of a deemed establishment where the head office of a corporation is located when it otherwise has no establishment;

— the attribution of each net premium, for a year, regarding insurance on property located in a foreign country where an insurance company otherwise has no establishment during the year, or regarding insurance arising from contracts entered into with persons residing in such country, to the province in Canada or foreign country where the establishment of the corporation to which it is reasonable to attribute the net premium is located.

Moreover, some measures will not be adopted because Québec's tax regulations already include satisfactory corresponding measures. These measures concern:

— a central paymaster;

— adjustments stemming from the operation of an international banking centre.

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1 S.C. 2009, c. 2.

2 Memorandum of Agreement Concerning a Single Administration of Ontario Corporate Tax, online <http://www.fin.gc.ca/toc/2006/txmoa-eng.asp> (consulted December 22, 2009).

1.2 News release 2009-085 of September 14, 2009

On September 14, 2009, the Department of Finance Canada issued, by means of a news release, a notice of ways and means motion to implement certain provisions of the budget tabled in Parliament on January 27, 2009 and to implement other measures.

These other measures concern, in particular, the existing tax deferral available to farmers who must dispose of breeding livestock in drought regions. The changes proposed by the federal government stipulate that this deferral will also be offered, as of 2008, to farmers in regions affected by flood or excessive moisture conditions covered by regulation. The notice of ways and means motion also specifies the prescribed regions as being affected by flood or excessive moisture conditions for 2008 and 2009, and regions affected by drought for 2007 to 2009.[3]

Québec's tax legislation and regulations will be amended to incorporate, with adaptations on the basis of their general principles, the amendments made to tax deferral on account of the sale of breeding livestock in regions affected by drought, announced September 14, 2009. These amendments will apply on the same dates as those for the purposes of the federal amendments to which they are harmonized.

1.3 News release 2009-088 of September 23, 2009

On September 23, 2009, the Minister of Finance of Canada issued a news release containing proposed amendments to the Excise Tax Act concerning a number of measures to improve and streamline the application of the goods and services tax (GST) and the harmonized sales tax (HST) in the financial services sector.

❑ Imported supplies and input tax credit allocation methods of financial institutions

The proposed amendments to the federal legislation concerning imported supplies and input tax credit (ITC) allocation methods of financial institutions essentially match those made public November 17, 2005[4] and January 26, 2007.[5] The decisions as to whether or not to harmonize the Québec sales tax (QST) system with these amendments have already been announced.[6]

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3 The legislative and regulatory provisions in question are currently in force. See S.C. 2009, c. 51, approved December 15, 2009.

4 DEPARTMENT OF FINANCE CANADA, *News Release 2005-079*, November 17, 2005.

5 DEPARTMENT OF FINANCE CANADA, *News Release 2007-006*, January 26, 2007.

6 MINISTÈRE DES FINANCES DU QUÉBEC, *Information Bulletin 2005-7*, December 19, 2005, p. 32 and MINISTÈRE DES FINANCES DU QUÉBEC, *2007-2008 Budget – Additional Information on the Budgetary Measures*, section A, p. A.78.

❑ New GST/HST rebate for registered pension plan trusts

The new rebate proposed by the federal government for registered pension plan trusts replaces a complex system of legislative and administrative rules with a system ensuring fair and equitable treatment for all registered pension plans.

Since the same rules also apply in the QST system, it is appropriate to incorporate this rebate measure, subject to the necessary adaptations stemming from the zero-rating of financial services in Québec's tax system.

Consequently, like the GST system, the QST system will be changed so that the tax calculated on expenses relating to a registered pension plan, incurred by employers participating in such plan, are deemed to have been paid by the pension entity of the plan, so that the latter will be entitled to the rebate of the tax it has paid or is deemed to have thus paid.

Similarly, the mechanism enabling the pension entity and all participating employers to jointly elect to transfer all or part of the rebate to which the pension entity is entitled to some or all of the participating employers that are registered will be stipulated in the QST system.

However, given that the GST rebate rate of 33% was established on the basis of the expenses relating to a registered pension plan that generally give rise to an ITC, i.e. only on the basis of the employer's expenses because of the exemption of the financial services supplied by the pension entity, the QST rebate rate will instead be 100% to reflect the zero-rating of financial services.

Also because of the zero-rating of financial services, the special rules applicable to a pension entity that comes under a registered pension plan to which 10% or more of the contributions are paid by listed financial institutions will not be included in the QST system.

Moreover, unlike the GST rebate rate, the QST rebate rate will be adjusted to reflect the case where the participating employers are public service bodies. The latter generally are not entitled to an input tax refund on their expenses, but only to a certain rebate of the QST paid in this regard that, for most such bodies, is less than what is allowed under the federal tax system.

Accordingly, in the case of a registered pension plan to which more than 50% of the contributions are paid by public service bodies entitled to a partial rebate of QST paid on their expenses attributable to the provision of exempted supplies, the rate of the rebate to which the pension entity will be entitled will be 88%.

In the case of a registered pension plan to which more than 50% of the contributions are paid by public service bodies entitled to no rebate of QST paid on their expenses attributable to the provision of exempted supplies, the rate of the rebate to which the pension entity will be entitled will be 77%.

Since the rebate rates applicable to registered pension plans to which contributions are mainly paid by public service bodies reflect the portion of expenses attributable to the provision of exempted supplies, the pension entity and the participating employers that elect to transfer all or part of the rebate to the latter or to some of them will be free to decide the proportion of the rebate thus transferred, with no limitation as to when they may deduct on that account in the calculation of their net tax.

For greater clarity, these adjusted rebate rates will also apply to a pension entity under a single-employer registered pension plan.

These changes to the QST system will be adopted only after the assent given to any legislation arising from the federal news release, taking into account technical amendments that might be made prior to such assent. They will apply on the same date as those for the purposes of the federal amendments to which they are harmonized.

❑ New GST/HST information return for financial institutions

The new return for financial institutions designed to obtain more information from them was created because of the complexity of their sector of activity and the specific rules that apply to them in the GST system, because they carry out both commercial and exempt (financial services) activities.

Given that financial institutions only carry out commercial activities in the QST system because of the zero-rating of financial services, these institutions are not subject to the same specific rules, so there is no need to obtain additional information from them. Consequently, this federal measure will not be incorporated in the Québec's tax system.

❑ Extension of filing due date of GST/HST returns for financial institutions

Since the QST system is harmonized with the GST system regarding the filing due date for listed financial institutions that file their tax returns on an annual basis, the extension of this due date from three to six months announced regarding the federal tax system will also apply in Québec's tax system.

This change to the QST system will be adopted only after the assent given to any legislation arising from the federal news release, taking into account technical amendments that might be made prior to such assent. It will apply on the same date as the one for the purposes of the federal measure to which it is harmonized.

1.4 News release 2009-115 of December 14, 2009

On December 14, 2009, the Minister of Finance of Canada, in a news release, issued a backgrounder containing technical legislative proposals further to recent court decisions that may have created uncertainty respecting the scope of the definition of "financial service" in the Excise Tax Act.

These legislative proposals clarify the tax treatment of certain administrative and management services and promotional services that represent inputs for financial services, by specifying that such services are not financial services under the Excise Tax Act and are therefore taxable for GST purposes.

In accordance with the principle of harmonization of the QST system with the GST system as to the definition of "financial service", Québec's tax system will be amended to expressly stipulate, like the federal system, that investment management services, services that facilitate financial services and services of managing credit are excluded from the definition of "financial service".

These changes to the QST system will be adopted only after the assent of any legislation or adoption of any regulation arising from the federal news release, taking into account technical amendments that might be made prior to such assent or adoption. They will apply on the same dates as those for the purposes of the federal amendments to which they are harmonized.

Concerning the changes relating to the definition of "financial service", the Minister of Revenue may establish a new assessment concerning the net tax of a person for a reporting period of the latter, to reflect any difference between the net tax it reported for the period and its net tax for the same period that would arise from the application of these changes. Such new assessment must be made on or before the later of:

— the day that is one year after the date the bill giving effect to the changes relating to the definition of "financial service" is assented;

— the last day of the new assessment period otherwise stipulated by the Act respecting the ministère du Revenu.

1.5 Extension of the remittance deadline for source deductions regarding a payment for services rendered by a non-resident

Québec's tax regulations stipulate that every person who makes a payment for services rendered in Québec by a person who does not reside in Canada, otherwise than in the course of regular and continuous employment, must deduct 9% of such payment.

Currently, an amount equal to the one thus deducted must be paid to the Minister of Revenue no later than the date on which the payer must make its employer remittances for the period during which the payment for services rendered in Québec was made.

As a general rule, the latest date on which a payer must make its employer remittances depends on the date of payment of an amount subject to withholding at source and the payer's average monthly withholding for the second calendar year preceding the one during which such amount is paid. For example, some payers may be required to make their remittances no later than the third day following the one during which an amount subject to income tax withholding is paid, while others may make their remittances the 15th day of the month following such a payment.

The federal tax system also stipulates that a deduction of tax must be made regarding a payment for services rendered by a non-resident person, otherwise than during the course of regular and continuous employment. However, the remittance of the amount equal to the one deducted regarding such payment must, in all cases, be made no later than the 15th day of the month following the one during which the payment for services rendered was made.

The disparity in deadlines for making remittances to each level of government can cause administrative difficulties for certain employers.

Accordingly, since Québec's tax system is generally harmonized with the federal tax system regarding the deadlines for remittances of deductions at source, Québec's tax regulations will be amended to stipulate that an amount equal to the one that is deducted regarding a payment for services rendered in Québec by a person who does not reside in Canada, otherwise than in the course of regular and continuous employment, must be paid to the Minister of Revenue no later than the 15th day of the month following the one during which the payment for services rendered is made.

This amendment will apply regarding a payment made after December 31, 2009 for services rendered in Québec.

2. CHANGES TO THE MEASURE RELATING TO THE DEFERRAL OF TAXATION OF AN ELIGIBLE REBATE

To facilitate the capitalization of certain categories of Québec cooperatives or federations of cooperatives by encouraging their members to reinvest in them, the tax system allows the rebates they attribute in the form preferred units, after February 21, 2002 and before January 1, 2013, to give rise to the deferred tax rebate mechanism, which allows tax to be deferred until the units are disposed of.

Briefly, a taxpayer who is a member either of a cooperative or a federation of cooperatives, or of a partnership that is a member of a cooperative or a federation of cooperatives can deduct, in calculating his taxable income, the amount of a rebate attributed to him in the form of a preferred unit or, if he is a member of a partnership, his share of the rebate, provided such cooperative or federation of cooperatives holds, for the taxation year regarding which the rebate is attributed, an eligibility certificate issued by the Minister of Economic Development, Innovation and Export Trade according to which it qualifies as a qualified cooperative.

Following the disposition of a preferred unit regarding which an eligible rebate deduction was allowed, the taxpayer who benefited from such deduction must generally include, in calculating his taxable income, the amount previously deducted regarding such unit.

The fiscal measure relating to the deferral of taxation of an eligible rebate is essentially intended to assist work cooperatives, shareholding workers cooperatives, producers cooperatives, agricultural cooperatives or federations of such cooperatives as well as certain forms of solidarity cooperatives, where most of their assets are located in Canada and their central management is carried out in Québec.

As a general rule, the categories of cooperatives or federations of cooperatives recognized for the purposes of the measure relating to the deferral of taxation of an eligible rebate are also recognized for the purposes of the cooperative investment plan, since these two measures have the same objective, i.e. facilitating the capitalization of Québec cooperatives and federations of cooperatives.

To better reflect the business reality of cooperatives and federations of cooperatives, various changes will be made to the measure relating to the deferral of taxation of an eligible rebate.

These changes will apply to the conditions to be satisfied to obtain an eligibility certificate to reflect, on the one hand, groups formed within solidarity cooperatives and, on the other, the growing presence abroad of certain cooperatives or federations of cooperatives.

They will also apply to the conditions to be satisfied for the disposition of a preferred unit in the event of a reorganization affecting the share capital does not result in ending the deferral of taxation of a rebate.

Lastly, an integrity rule will be implemented to ensure that the members of a partnership who are attributed an eligible rebate receive a fair share of the benefit of the deferred tax rebate mechanism.

2.1 Recognition of solidarity cooperatives including worker members and producer members

Solidarity cooperatives are a relatively new phenomenon in Québec. They differ from other cooperatives by the diversity of their members and their openness to partnership. These cooperatives include at least two member categories among those of user members,[7] worker members[8] and support members.[9]

Currently, the measure relating to the deferral of taxation of an eligible rebate recognizes, among the categories of cooperatives for which the measure is intended, two forms of solidarity cooperative.

They are solidarity cooperatives that would be work cooperatives were it not for their support members, and solidarity cooperatives that would be producers cooperatives were it not for their support members and if at least 90% of the goods or services they supply[10] are supplied to persons or to partnerships that acquire them for the purpose of earning a business income.

A cooperative that belongs to any of these forms of solidarity cooperative and satisfies the other applicable criteria for obtaining an eligibility certificate for a taxation year can pay regarding such year, in the form of preferred units, a rebate giving rise to the deferred tax rebate mechanism.

Moreover, since June 24, 2009, a new form of solidarity cooperative including worker members and producer members has been recognized for the purposes of the cooperative investment plan.[11]

Since the categories of cooperatives or federations of cooperatives recognized for the purposes of this plan and those recognized for the purposes of the measure relating to the deferral of taxation of an eligible rebate have always been substantially the same, a change will be made to the eligibility criteria for the latter measure to recognized solidarity cooperatives including worker members and producer members.[12]

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7 I.e. persons or partnerships that use the services provided by the cooperative.

8 I.e. the natural persons working within the cooperative.

9 I.e. any person or partnership that has an economic, social or cultural interest in achieving the purpose of the cooperative.

10 Including those supplied through a partnership or a controlled subsidiary.

11 MINISTÈRE DES FINANCES DU QUÉBEC, *Information Bulletin 2009-4*, June 23, 2009, measure 6.2.

12 This change will be found in the framework legislation consolidating the non-tax parameters of certain fiscal measures and whose introduction was announced in *Information Bulletin 2007-10*, on page 16.

More specifically, the categories of cooperatives recognized for the purposes of the measure relating to the deferral of taxation of an eligible rebate will include solidarity cooperatives, with or without support members, that include worker members and user members, provided, on the one hand, that each user member of the cooperative is a producer, as this expression is understood in the Cooperatives Act,[13] and, on the other, that at least 90% of the goods or services supplied to users by the cooperative[14] are supplied to persons or partnerships that acquire them for the purpose of earning a business income.

This change will take effect as of June 24, 2009.

2.2 Replacement of the criterion relating to the location of the assets

Currently, to obtain an eligibility certificate for a taxation year ending after October 29, 2009, a cooperative or a federation of cooperatives belonging for the year to a category of recognized cooperatives or federations of cooperatives must, in addition to carrying out its central management in Québec for the year, satisfy the criterion relating to the location of its assets at the end of its last taxation year preceding the year for which application is made for the certificate.

This criterion is satisfied if, in the case of a shareholding workers cooperative, most of the assets held by the legal person of which it is a shareholder are situated in Canada and, in other cases, most of the assets held by the cooperative or federation of cooperatives, as the case may be, including those held by a controlled subsidiary, by a partnership of which it is the majority member or by a trust in which it transferred assets, are situated in Canada.

To prevent the criterion relating to the location of the assets from constituting, for certain Québec cooperatives or federations of cooperatives, an impediment to their foreign expansion projects, which may have positive effects on maintaining the level of employment or economic activity in Québec, this criterion will replaced by a criterion regarding the attachment of the members to Québec's territory.[15]

More specifically, this new criterion will be satisfied by a cooperative or a federation of cooperatives, as the case may be, if, at the end of the taxation year for which it submits an application for an eligibility certificate to the Minister of Economic Development, Innovation and Export Trade, most of its members[16] are domiciled in Québec, if the member is a natural person, or have an establishment in Québec in other cases.

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13 As understood by this statute, a producer is a person or partnership that, in the course of exercising his profession or carrying on a business, provides services or produces goods in order to earn the means for his or its existence or his or its main income from a business or profession.

14 *Supra*, note 10.

15 *Supra*, note 12.

16 To that end, the expression "member" includes neither a supporting member (investor member), nor an auxiliary member (probationary member), nor an associate member (consumer member of an agricultural cooperative).

This change will apply regarding an eligibility certificate application for a taxation year that ends after the date of publication of this information bulletin.

For greater clarity, the application submitted by a cooperative or a federation of cooperatives for an eligibility certificate must be accompanied by a statement signed by two directors or officers certifying that the criterion regarding the attachment of the members to Québec's territory is satisfied.

2.3 Restriction to situations allowing the deferral of taxation of an eligible rebate despite a disposition

As a general rule, the disposition of a preferred unit regarding which an eligible rebate deduction was allowed ends the deferral of taxation of such rebate.

However, the tax legislation stipulates that some forms of reorganization affecting the share capital of a cooperative or federation of cooperatives, such as a merger or capital reorganization, do not end the deferral of taxation of an eligible rebate, if another preferred unit is issued to replace the unit disposed of because of such reorganization.

To ensure the integrity of the measure relating to the deferral of taxation of an eligible rebate, the tax legislation will be amended to better delineate the exceptional situations in which deferral of taxation of a rebate attributed by a cooperative or a federation of cooperatives regarding a taxation year for which it held an eligibility certificate is maintained, despite the disposition of the preferred unit relating to such rebate.

Accordingly, the only exceptional situations that will be recognized are those where the disposition of a preferred unit is part of an operation, consisting of a capital reorganization, conversion of units or a merger, under which all the outstanding preferred units issued on account of tax deferred rebate regarding a given taxation year are exchanged for consideration consisting solely of preferred units or fractions of such units having the same characteristics, with the exception of the order of priority of redemption of the units in the case of winding-up, as those they replace.

This amendment will apply regarding a capital reorganization, conversion of units or merger carried out after the date of publication of this information bulletin.

2.4 New rule concerning the allocation of eligible rebates among members of a partnership

Currently, where a partnership receives, at any time prior to January 1, 2013, a rebate issued in the form of a preferred unit, a taxpayer who is a member of the partnership at its fiscal year-end including that time is considered to have received on account of an eligible rebate at such time and included in the calculation of his income for the taxation year during which such fiscal year ends, the portion of the rebate received by the partnership represented by his share of the rebate.

To prevent the method of allocating a rebate among the members of a partnership from being established so as to allow certain members to obtain a greater tax benefit than they would have obtained had the rebate been allocated on the basis of the share of each member in the partnership's income or loss, the tax legislation will, for the purposes of the definition of the expression "qualified patronage dividends", be amended to stipulate the method of allocation of a rebate received by a partnership.

More specifically, where a partnership receives, at any time prior to January 1, 2013, a rebate issued in the form of a preferred unit, a taxpayer who is a member of a partnership at its fiscal year-end including such time will be deemed to have received at such time and included in the calculation of his income for the taxation year during which such fiscal year ends, the proportion of the rebate received by the partnership represented by dividing the taxpayer's share of the partnership's income or loss for the fiscal year by the partnership's income or loss for the fiscal year, assuming, if the partnership's income or loss for such is zero, that the partnership's income for such fiscal year is equal to $1 000 000.

This amendment will apply regarding a rebate attributed for a taxation year that ends after the date of publication of this information bulletin.